

***United States Court of Appeals
for the Second Circuit***



**APPELLANT'S
REPLY BRIEF**

74-1693
74-1704

To be argued by
ROY M. COHN

In The
United States Court of Appeals
For The Second Circuit

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee,

vs.

TILNEY & COMPANY,
FREDERICK TILNEY,

Defendants-Appellants,

— and —

I. ALAN HARRIS (Cross-Appellant);
JOSEPH C. HOGAN;

Appellee.

On Appeal from Judgment of the United States District
Court for the Southern District of New York

REPLY BRIEF FOR DEFENDANTS -APPELLANTS
TILNEY & COMPANY; FREDERICK TILNEY

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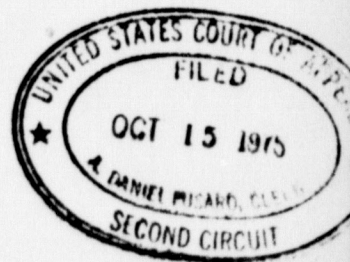


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REPLY TO ANSWERING BRIEF OF JOSEPH C. HOGAN

Prior Proceedings in this Court

After this Court had reduced the \$150,000 bond suggested in the court below to \$25,000, defendants made every effort to raise this amount but in order to accomplish the program it was found necessary to borrow no less than \$75,000 to cover the bond and

restraint of \$7,074.88 and to clear off accumulated tax liens which the receiver had allowed to pile up on property as well as to bring mortgage payments current and meet other pressing obligations. Without the full amount of the loan, no program could have been put in place since all of defendants' assets were held by the receiver and would have to be turned over simultaneously with provision for the payment of accumulated encumbrances.

Being unable to raise these funds in the summer of 1974, there was no means by which the bond could be made as a practical matter. As a result, through the operation of tax liens and default judgments, real properties with a value of approximately \$300,000 have been lost to the receivership estate.

The Consent Judgment

The Hogan brief on pages 7 and 8 asserts that Tilney & Company on November 9, 1967 was in alleged violation of the net capital rule to the extent of \$247,657.99 but fails to note that at the hearing on December 6, 1967 the Commission alleged that after allowing for the haircut on proprietary securities there was an alleged net capital deficit of 92-odd thousand dollars (A.p. 22).

The Hogan brief on page 9 neglects to note the complete scope of the authority specified in the consent judgment. The judgment specified "The receiver is hereby authorized to employ such attorneys, accountants, security experts and other employees as may be necessary in discharging the above authority." (Emphasis supplied) (A.pp. 25-28)

No security experts were employed to the great detriment of the estate. The use of security experts would have assisted and protected the receivers through appraisals of closely held securities involving control or merger prospects and similar factors.

Commencement of the Receivership

The records of Tilney & Company were not in utter chaos as asserted in the Hogan brief on page 10. A detailed summary of position of Tilney & Company was furnished the receivers on December 19, 1967 and has proved to be accurate (A.pp. 1360-1390). The summary of position included a breakdown of all individual customer accounts as taken from the firm's basic record books (A.pp. 1377-1385). Hogan stated on February 27, 1968 "I think, Judge, with reference to the customer accounts the Court should be apprised of the fact that they kept a pretty accurate stock record book in Tilney & Company, and from the stock record book you can see who allegedly owned the securities, and also, of course, you can check the securities for X dividend dates." (A.p. 63) and again at a hearing on May 6, 1971 receiver Hogan stated, "I think, your Honor, that Mr. Tilney's stock record books confirm these figures. We agree upon them." (A.p. 686)

The summary of position in Tilney's December 19, 1967 report to the receivers showed that the total value of assets held by the firm was \$2,081,847 of which \$1,241,444 represented marketable securities or cash including free securities and securities under

loan contributed by the general partner. Total loans were \$684,127 including a loan of the general partner, leaving \$557,317 as equity, considering only cash and marketable securities valued at \$1,241,444 (A.p. 1363). Offsetting this equity were funds and securities due customers including members of the partner's family and accounts payable totaling \$302,055 (A.pp. 1363, 1377-1385). These were satisfied by the receiver for \$249,446 (A.p. 1268) including one claim of a family member in the amount of \$6,231 (A.p. 1288).

The firm's bank accounts were not in a state of confusion as alleged in the Hogan brief on page 10. The summary of position showed no overdrafts (A.p. 1372) and is confirmed by the accountants in Schedule 5, page 1, of Document 228. Tilney & Company had only one overdraft which was with the First National City Bank and had arisen at the time the firm's operations were suspended by the Commission in August 1967. This overdraft was reduced to a judgment in October 1967 (A.p. 77).

There was no Tilney & Company overdraft with the Tinker National Bank as noted in the Hogan brief, page 10. This liability was an unsecured joint note of Frederick and Dorothy Tilney and was not reported as a liability of Tilney & Company (Document 228, Schedule 20) nor was it reported in the summary of position of Tilney & Company (A.p. 1360). The bank elected to file a claim against the receivership which was satisfied (A.p. 566).

Typical of the financial gimmickry and distortions used

by the receivers and their accountants is the statement on page 10 of the Hogan brief that demand loans as of December 17, 1967 totaled \$663,334.27 and the securities pledged to cover these demand loans had a value of only \$616,096.23. The collateral demand loans of Tilney & Company were actually paid in the amount of \$643,841.48 of which \$640,892 was raised through the sale of collateral (A.p. 1268). The bank loans and interest actually paid was \$19,492.79 less than the amount alleged by the receiver in his brief.

A careful analysis of the record clearly demonstrates that the value of the collateral securing Tilney & Company's four bank loans was greatly in excess of the \$616,096.68 alleged in the Hogan brief on pages 10 and 11 (A.p. 89).

The Franklin National Bank loan had an interest and principal balance due as of December 17, 1967 of \$363,326.61 (A.pp. 89, 1367). The collateral securing the loan had a value of \$378,210 (A.pp. 37, 1367), not \$198,996.38 (A.p. 89), a difference of \$179,213.62.

The Long Island National Bank loan had a collateral value as of December 19, 1967 of \$248,841 (A.p. 1369) rather than \$146,205.31 (A.p. 89). The receivers indicated that after deducting loan principal and interest of \$145,520.83 there was an excess value in this loan of only \$3,535.68 (A.p. 89). By May 31, 1968, however, the excess value had increased to \$44,051.89, indicating that while the accountant's report was being prepared the higher

valuation, \$248,841, in the defendants' summary of position of December 19, 1967 was being attained (A.p. 1299). Credit should have been given for at least the specific improvement of \$41,516.21.

In the case of the Matanuska Valley Bank loan the estimate of collateral value furnished the receivers on December 19, 1967 was \$146,721 (A.p. 1370) rather than \$94,320.41 (A.p. 89). The collateral security in this loan was liquidated for \$134,367.81 as computed from the final accounting (A.pp. 1273-1274). Several of these sales were protested in the unheard surcharge in the court below. Clearly the estimate of the collateral value in this loan should have been substantially higher -- at least to the extent of the difference between the value at which the securities were sold and the value assigned by the receivers and their accountants as of December 17, 1967 or \$ 40,065.40.

An even more blatant error in establishing the value of the collateral as compared with the loans appears in the case of the Marine Midland Grace Trust Company loan. This loan was liquidated January 9, 1968 and the excess collateral released (Harris Brief, p. 16). The accountants valued the collateral in the loan as of December 17, 1967 at \$176,592.18 (A.p.89). The defendants as of December 19, 1967 valued this collateral at \$198,906, a difference of \$22,313.82. Subsequent sales of all but one item of excess collateral in this loan support the defendants' values (A.p. 1273).

The alleged value of the collateral of the loans at the inception of the receivership should have been increased as follows on page 7.

Franklin National Bank	\$179,213.62
Long Island National Bank	41,516.21
Matanuska Valley Bank	40,065.40
Marine Midland Grace Trust Company	<u>22,313.82</u>
Total Increase	\$283,109.05

The increases in collateral values and the \$19,492.79 overstatement of the loans together total \$302,601.84 and would entirely eliminate the \$47,239.99 undercollateralization at the inception of the receivership alleged in the Hogan brief on page 10.

Liquidation of Securities

As if to add insult to injury, the Hogan brief on page 12 indicates that by some legerdemain the receivers between December 17, 1967 and May 31, 1968 "transferred an undercollateralization of more than \$47,000 to an excess of collateral value of approximately \$64,000 over the principal and interest owing to the banks" when in fact there had never been an aggregate undercollateralization. The alleged undercollateralization if viewed in the most charitable sense was a figment of some one's imagination, poor accounting practices or possibly a disagreement regarding the methods of valuation to be used between the receivers or the receivers and their retainers (A.pp. 95-98).

Even in stating that they had converted a mythical undercollateralization of \$47,000 as of December 17, 1967 to an excess collateral value of \$64,000 by May 31, 1968, the receiver neglected

to include the excess collateral released from the Marine Midland Grace Trust Company loan which had a value according to their own figures on December 17, 1967 of \$87,319.03 which when added would indicate a total excess collateral value of over \$151,000 as of May 31, 1968 (A.p. 89).

This example of erroneous and deceptive presentation continued throughout the receivership. The receivers and their accountants presented inaccurate figures to the court below, the Commission and creditors as to the status of the receivership. They overstated liabilities and omitted or understated the value of assets. These inaccuracies are best demonstrated by a comparison of the eleven reports submitted by the receivers' accountants and one by the receivers as compared with three reports submitted by the defendants.

In the tabulation following on page 9 the admitted assets and liabilities of Tilney & Company and Frederick Tilney are shown by the receivers or their accountants as of the commencement of the receivership, its termination and on ten intervening dates.

The defendants submitted comparative figures to the receivers as of December 19, 1967, as noted on page 2 of this brief, and as of July 31, 1968 and June 30, 1969. These figures are included in the tabulation.

The tabulation indicates the sources of the reports and the appendix page numbers from which the figures are derived. Admitted assets of Tilney & Company include only marketable securities and cash or cash equivalents except as noted.

COMPARATIVE TABULATION OF FINANCIAL REPORTS

Date	Source	Appendix Page No.	Milner & Company			Frederick Tiline			Combined			Notes
			Admitted Assets	Liabili- ties	Net Worth	Admitted Assets	Liabili- ties	Net Worth	Admitted Assets	Liabilities	Net Worth	
12/19/67	Defendants, 12/19/67, & Accountants, 12/17/67	1363	\$1,241,444	\$996,182	\$ 255,262	\$447,520	\$308,165	\$139,355	\$1,688,964	\$1,294,347	\$394,617	(1)
12/17/67	Accountants	81- 83	719,984	957,561	(238,477)	515,086	335,165	179,921	1,234,170	1,292,726	(58,556)	
2/26/68	Accountants	34	863,266	779,165	84,101	447,520	308,165	139,355	1,310,786	1,087,330	223,456	(2)
5/31/68	Accountants	81- 83	394,682	463,237	(68,555)	311,287	321,766	1,521	717,969	785,003	(67,034)	
7/31/68	Receivers	113- 116	331,273	361,362	(50,089)	105,958	255,304	(69,346)	517,231	636,666	(119,435)	(3)
7/31/68	Defendants	121- 126	606,112	387,530	218,582	40,893	23,360	17,533	647,005	410,890	236,115	(4)
6/30/69	Accountants	230- 231	339,104	297,148	41,956	186,268	276,753	(90,485)	525,372	573,901	(48,529)	(5)
6/30/69	Defendants	246- 250	413,431	217,879	195,561	30,663	13,583	17,080	444,094	231,453	212,641	(6)
10/31/69	Accountants	328- 329	345,620	297,148	48,472	176,507	145,780	30,727	522,127	442,928	79,199	
9/30/70	Accountants	592	--	--	--	--	--	--	620,798	396,423	224,375	
10/31/70	Accountants	616- 617	443,835	330,736	113,099	202,920	45,092	157,828	646,755	375,828	270,927	
6/30/71	Accountants	747- 748	396,736	242,550	154,186	166,611	42,395	124,216	563,347	284,945	278,402	
10/31/71	Accountants	830- 822	281,582	90,710	200,872	155,172	24,261	130,911	436,754	104,971	331,783	(7)
10/31/72	Accountants	1295	249,680	63,755	185,925	147,727	18,412	129,315	397,407	82,167	315,240	
7/31/73	Final	1265-1266	43,878	3,548	40,330	154,114	17,721	136,393	197,392	21,269	176,123	

NOTES FOLLOW ON PAGE 10

Notes to Table on Page 9

General Notes: Assets without established markets are eliminated throughout although defendants' figures in some instances take some of these into account as offsets to family or affiliate's claims.

- (1) The defendants at the commencement of the receivership had furnished the receivers with a summary of position as to the status of Tilney & Company (A.p. 1363). No report was furnished as to the status of the general partner's position. In order to establish comparability for the purpose of this tabulation, the figures presented by the accountants as to the general partner's position as of December 17, 1967 are used after deducting partner's securities contributed at the values established by the receivers' accountants, \$67,566 (Document 228, Schedule 19), and eliminating a loan secured by them (Document 228, Schedule 20).

The use of the accountants' figures must not be construed as an admission that they are correct and do not contain serious omissions of assets of value, undervaluations and overstatement of liabilities.

- (2) The receivers' accountants prepared a report for Tilney & Company as of February 26, 1968 in which they included all of the general partner's securities which they valued at \$54,000. No material changes had taken place in the general partner's accounts since December 17, 1967 other than the sale of securities securing a bank loan and properly considered by the accountants as assets of the partnership. The figures for the general partner reported as of December 19, 1967 on the first line of this tabulation, therefore, are repeated (Note 1 above) (see also A.p. 34 for report of 2/26/68).
- (3) These financial reports were prepared by the receivers as of July 31, 1968 and were attached to a letter to creditors dated October 31, 1968 enclosing claim forms which letter, however, was not mailed until December 16, 1968 (A.pp. 107, 982).
- (4) This report was submitted by defendants for the benefit of the receivers to demonstrate the ability of the estate to close with all customers and creditors of Tilney & Company paid in full and Frederick Tilney's liabilities liquidated with the exception of those of his family and a bank which were to be secured by property not valued by the receivers.
- (5) This report was prepared by the receivers' accountants in connection with the resignation of receiver Harris and after the settlement and payment of the Nome suit.
- (6) This report by the defendants was requested by the SEC on July 16, 1969 and so ordered by the Court.

- (7) Reports submitted by the receiver's accountants as of October 31, 1971 and thereafter include real property seized from Governmental Statistical Corporation through a Sheriff's sale in September 1971 and carried at the bought-in value of \$38,466.

After the payment of all collateral loans and unsecured creditors, the receiver's final accounting reported assets on hand with a net value of \$176,723. During the course of the receivership, in addition to paying creditors the receivers disbursed \$381,051.02 as expenses of administration of the estate including interest to customer creditors and the settlement of the Nome law suit.

<u>A.p.</u>	<u>Other Expenses</u>	
1278	D-1, Receivers' expenses and costs, Tilney & Company	\$ 50,762.00
1279	D-2, Receivers' expenses and costs, Frederick Tilney	65,557.00
1279	D-3 Administration fees and expenses	202,715.02
1280	D-4, Other disbursements	1,367.00
1269	Settlement, Nome law suit	20,000.00
1268	Payment of interest to customers	38,761.00
1269	Advance, Dorothy M. Tilney	689.00
1269	Advance, Governmental Statistical Corporation	1,000.00
1270	Bond	<u>200.00</u>
		\$381,051.02

To offset the expenses, the final accounting reported interest and dividends of \$99,501.26 (A.pp. 1276-1277). In addition, dividends on Central Alaska Utilities stock were received in the amount of \$3,450 (A.p. 1268). These income items offset the expenses paid by the receivers and resulted in net expenses of \$278,099.76.

It is alleged in the surcharge, which this appeal seeks to have adjudicated, that specific sales of securities were made at losses to the estate totaling \$448,000 (A.pp. 938-939). Included in these losses was the sale of a security, City Commerce Corporation debentures, to an insider at a loss of \$100,000 (A.p. 1300).

The expeditious closing of this receivership would have resulted in a material saving of expenses and substantial recoveries. Through the delay and misinformation as to values and other improper acts, the receivers have caused tremendous damages for which compensation is sought.

Contrary to Hogan's claim that the SEC approved all sales (Hogan Brief, p. 13) and had full knowledge of them, nothing in the record discloses any blanket approval of sales by the SEC who in fact stated on October 15, 1970 "We were relying in the liquidation of assets on the judgment of court appointed officers." (A.p. 606).

Receiver Hogan in his brief states on page 13 that Frederick Tilney approved or acquiesced to all sales of securities. There is nothing in the record to support this statement other than Harris' self-serving comments before the court below at a hearing on May 4, 1972 (A.pp. 1038-1039).

The City of Nome Matter

Hogan alleges that Tilney's attitude towards the Nome settlement caused additional work and expense (Hogan Brief, p. 14). The facts are that the Nome settlement was not consummated until Tilney

traveled to Alaska in December 1968. A hearing on November 18, 1968 revealed that far from having settled the Nome suit as of that date the receivers were burdened with the suit and had retained counsel to contest it in the Alaska courts (A.pp. 140-147). Tilney announced that he was going to Alaska (A.p. 151); Harris objected but the Court did not order Tilney not to make the trip (A.p. 151). As a result of the trip, the suit was settled without any additional effort. The record indicates that counsel for the receivers conferred on the settlement on December 20, 1968 (Exhibit 1, p. 29) after Tilney's conference in Anchorage. Subsequent time reported by the receivers and counsel involved the preparation of the various legal documents to consummate the settlement on April 15, 1969 (A.pp. 167-168; Exhibit 1, pp. 32-34).

Claim Against D. Raymond Kerney & Co.

Contrary to the insinuations that Tilney's tax memorandum delayed the Kenney settlement, the record shows no such thing. The memorandum was submitted November 18, 1968 and the very next day the Court ordered the settlement and the satisfaction was before receiver Hogan on November 22, 1968 (A.p. 153; Exhibit 1, p. 28).

The Kenney claim had not arisen until October 1966 when that firm defaulted on its account to Tilney & Company and Tilney had not been trying for years to collect as the Hogan brief on page 15 would lead this Court to believe.

Sale of Alaska Real Estate

The Hogan brief on page 15 does not accurately portray the events leading to the eventual sale of this property. Hogan stated that Tilney opposed the sale of the property at \$32,000 but that the Court approved the sale which resulted in a gain of more than \$12,000 to the estate.

The facts are that Hogan had agreed to sell the property for \$20,000 but, when confronted with an appraisal showing the property to be worth \$45,000 upon which Tilney relied, renegotiated the sale and obtained a revised offer of \$32,000 net from the original purchaser. This was admitted by Hogan in his affidavit to the Court for allowances when he stated:

* * * * *

"An appraisal of the property was ordered, but before receipt of same a firm counter-offer was made in the amount of \$20,000. Said offer was accepted subject to an appraisal and court approval."

"The appraisal, when received, estimated the value of the property to be \$45,000.00, which seemed high according to information obtained by your deponent at the time of foreclosure. However, with some embarrassment, your deponent renegotiated with the agent for the purchaser and succeeded in obtaining an offer in writing of \$32,000.00. net."
(A.p. 407)

* * * * *

The SEC requested additional appraisals as required by Section 2001 of Chapter 28 of the United States Code and after receipt of these Tilney in a letter to the Court consented to the sale of the property at \$32,000 (A.p. 564).

REPLY TO ANSWERING BRIEF OF
I. ALAN HARRIS

The Waddington Bank

The Harris brief on page 29 repeats his allegations "The bank was found by Studley to be in terrible condition." These allegations of a poor condition were the primary excuse for Harris becoming involved in the control of the bank and had been stated on the record prior to the auction which undoubtedly contributed to the poor results, as previously noted in appellant's brief on page 37.

The purchaser at the auction, Harry S. Pack, Esq., who after his purchase became Chairman of the Board and a director of The Waddington Bank, took exception to the allegations of poor condition as noted in an affidavit (A.p. 1011). Mr. Pack was present in Court on May 4, 1972, prepared to testify as to the contents of his affidavit but the court below afforded no opportunity for him to be examined.

No appraisal of the value of this security was made before its original sale and no appraisal was made before the subsequent resale although Tilney requested the Court to have one made.

Respectfully submitted,

SAXE, BACON & BOLAN P.C.
Attorneys for Defendants-Appellants,
Tilney & Company, Frederick Tilney

Sale of Alaska Real Estate

The Board noted on page 15 does not accurately portray the events leading to the eventual sale of this property. It was stated that this property was sold at the necessity of \$11,000 but that the Court reported the sale which resulted in a gain of over \$11,000 to the estate.

The facts are that Board had agreed to sell the property for \$10,000 but, when confronted with an overbid, the property was sold for \$11,000 more which Tilly called, recommended the sale and obtained a revised offer of \$11,000 from the original purchaser. This was admitted by Board in his affidavit in the lower court proceedings when he stated:

"The statement of the property was correct, but before receipt of same a final counter-offer was made to the amount of \$11,000. This offer was accepted subject to an overbid and court approval."

"The overbid, then received, exceeded the value of the property to be \$11,000.00, which amount I had according to the former offer obtained by my account at the time of the sale. However, when the overbid was received, your witness recommended that the agent for the purchaser and respondent be obtained in order to obtain a revised offer of \$11,000.00."

(A.p. 40X)

The Board requested additional explanation as requested by Section 2001 of Chapter 15 of the Alaska Statutes Code and after receipt of same Tilly in a letter to the Court confessed to the sale of the property at \$11,000 (A.p. 40X).

AFFIDAVIT OF SERVICE BY MAIL

STATE OF NEW YORK)
) ss.
COUNTY OF NASSAU)

CASPER L. CLEMENTE, being duly sworn, deposes and says:

That he is President of the Davenport Press, Inc., printers of the attached Brief in the matter of SECURITIES AND EXCHANGE COMMISSION, Plaintiff-Appellee, vs. TILNEY & COMPANY, FREDERICK TILNEY, Defendants-Appellants, No. 74-1693 and No. 74-1704.

That on the 9th day of October 1975 he served two (2) copies of said Brief on:

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by depositing same, securely enclosed in a post paid wrapper in a Post Office regularly maintained by the United States Government at Mineola, New York, County of Nassau, directed to said attorneys at the addresses listed above, those being the addresses within the State designated for that purpose upon the preceding papers in this action, or the places where they then kept offices between which places there was and now is a regular communication by mail.

Deponent is over the age of 21 years.

Sworn to before me this
9th day of October 1975

PATRICIA A. MAKOPSKA
NOTARY PUBLIC, State of New York
No. 4608762
Qualified in Nassau County
Commission Expires March 30, 1977

Casper L. Clemente
CASPER L. CLEMENTE